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TAGS: EFIN EREL ETRD PGOV PREL UP XH
SUBJECT: TYMOSHENKO'S NBU DISPUTES DEEPEN

REF: KYIV 1557

Classified By: Acting Economic Counselor Kaye Lee for Reasons 1.4 (b) a
nd (d)

¶1. (C) Summary. A dispute between the National Bank of Ukraine (NBU) and Prime Minister Tymoshenko's government has escalated in recent days. At stake is the future of a major Ukrainian bank under temporary administration as well as the potential for additional capital infusions into two smaller banks that were recently nationalized by the GOU. The tension has spilled over from the banking sector to fiscal policy, with the NBU suggesting it may refuse to monetize GOU treasury bills which are expected to be issued to finance Ukraine's 2009 fiscal deficit and Naftohaz payments to Gazprom. End summary.

NBU-GOU DISPUTE OVER NADRA

¶2. (C) Acrimony between NBU officials and the GOU, recently flaring into the public domain when Minister of Interior Lutsenko launched an investigation of NBU Deputy Governor Shapovalov (reftel), has been evident in negotiations over the future of Nadra bank, Ukraine's largest private domestic bank under temporary government administration. It is widely expected that the government will recapitalize Nadra, though the bank's fate may rest on finding a compromise among Ukraine's authorities.

¶3. (C) Nadra vice president Nikolay Onishchenko acknowledged to econoff that the fate of Nadra was still unclear, even though Tymoshenko had given bank officials an end-November deadline to complete restructuring talks. Nadra officials told us that the bank had chosen UBS to serve as a lead dealer on its $175 million Eurobond restructure, and that it was making progress on finalizing terms with export credit agencies (including U.S. Export-Import Bank and the Department of Agriculture's Commodity Credit Corporation, whose representatives were in Kyiv in recent weeks for negotiations with Nadra). Nadra's biggest concerns were with major trade finance creditors. The inability of Nadra's temporary administrator to quickly establish a plan to restructure trade finance debt, including $125 million owed to Cargill, had apparently exacerbated the rift between Tymoshenko and the NBU (which appointed and supports the temporary administrator).

¶4. (C) Cargill Trade and Structured Finance representative Ross Jennings (protect throughout) told us that NBU governor Stelmakh had backed out of a verbal agreement with Tymoshenko, made in the presence of Cargill negotiators in July, to relieve Nadra's temporary administrator Valentina

Zhukovska of her duties. According to Jennings, Zhukovska had been seen as an impediment to a restructuring deal, perhaps acting on the behest of President Yushchenko, for whom her son, Roman Zhukovskyi, works as a senior economic advisor. (Note: For his part, Zhukovskyi recently admitted to us that he had been familiar with the Nadra situation, as it had "required the attention of the President." End note.)

¶5. (C) Cargill speculated that the President had advised both Stelmakh and Zhukovska to block a deal on Nadra's restructuring, and had supported Zhukovska's decision to stay on at the bank in order to accomplish that goal. Absent enough resources in Ukraine's thinly stretched Deposit Insurance Fund, Tymoshenko would be forced to cope with the political fallout from thousands of disgruntled depositors in the event of Nadra's liquidation. Zhukovska herself cagily told us that she had been agnostic about staying on at Nadra, and had proposed Tymoshenko advisor and Ministry of Finance director for bank recapitalization, Timur Bagirov, as a possible replacement, but that Bagirov had refused the position.

¶6. (C) Concerned it was caught up in the midst of bickering between the Tymoshenko government and Yushchenko allies, Cargill had backed away from the restructure negotiations. Jennings told us that Cargill also had been frustrated with the "procedure-oriented" demands of fellow trade finance creditors, such as Standard Bank and Kommerzbank, whose requirements for a second audit by Ernst and Young had further delayed the restructuring process. Cargill told us, however, that it had reengaged Ukrainian authorities with a recently drafted letter, on behalf of the trade finance creditor committee, that outlined general terms for a restructuring deal, but that it had not received a response. Bagirov, in turn, told us that the Ministry of Finance had received the Cargill letter and was open to the parameters outlined by Cargill and the other creditors, but that the GOU could not "force" the NBU and Nadra's Zhukovska to the table. He confirmed that Cargill had made overtures and expressed a willingness to talk again with Ukrainian authorities. (Note: During recent meetings with senior NBU managers, we were told that the NBU was attempting to "stay out" of politics, though the NBU had been "under constant pressure" from the GOU. End comment.)

¶7. (SBU) Separately, a prominent Kyiv daily revealed on October 13 that Nadra had published the full list of its 42,000 borrowers who collectively owe UAH 8.5 billion (nearly $1 billion), including corporate, small and medium enterprise, and private household clients. Although a technical violation of bank secrecy laws, this move may have been verbally ordered by Yushchenko in an effort to shed light on Nadra's defaulted debtors. Nonetheless, explicit permission for such a general disclosure was not allowed for in the President's October 8 decree (number 813), which had focused more narrowly on delinquent borrowers.

"UKRPROMBANK IS DEAD"

¶8. (C) Bagirov acknowledged that Ukrprombank, a second major domestic bank under temporary administration, was "dead" and would not be made viable. The Ministry of Finance would uphold a decision by the state recapitalization board and the Cabinet of Ministers to liquidate Ukrprombank's remaining assets. Bagirov said Ukrprombank had not been operational for 6-8 months, that 60% of its assets had been "tied up in a nasty legal dispute" the GOU "didn't want to touch," and that the impact of its liquidation on the Ukrainian financial system had already been factored in by the markets.

¶9. (C) A NBU-led purchase and assumption agreement would allow for the transfer of a portion of Ukrprombank's assets and deposits to newly nationalized Rodovid Bank, whose temporary administrator was given a short-term extension to oversee the deal. This plan, first articulated nearly five weeks ago, is yet to be implemented, though Bagirov has told

us that UAH 6.9 billion in deposits would soon be transferred to Rodovid, with another UAH 2.8 billion allocated to repay the NBU for refinancing funds.

ANOTHER INJECTION FOR RODOVID

¶10. (C) Rodovid Bank, one of three domestic banks recently recapitalized by the GOU (to the tune of UAH 2.8 billion or roughly $330 million), announced publicly that it required "top off" funds of UAH 1 billion to pay for unexpected deteriorations in its loan portfolio. However, Rodovid's temporary administrator, Sergiy Scherbyna, told us that the figure needed from the GOU was even greater. Scherbyna said Rodovid had a gap of over UAH 1.5 billion, though he noted that the bank would not request a capital injection if it received Ukrprombank's UAH 2.5 billion in performing loans, plus enough Ministry of Finance treasury bills (monetized by the central bank) to offset the transfer of Ukrprombank's UAH 7 billion in liabilities. In addition to assuming a portion of Ukrprombank's assets and liabilities, Rodovid was also planning to hire Ukrprombank personnel and rebrand its retail operations. (Note: Bagirov said separately that Ukrprombank's UAH 2.5 billion in sound assets constituted 25% of its total assets. End note.)

¶11. (C) Bagirov also told us that Rodovid had "unresolved provisions," and that the Ministry of Finance would increase its capital if Rodovid's management came to the conclusion that its gap was substantial. He praised Rodovid for its relatively strong information technology capacity, especially compared to the Ukrainian state-owned Oshchadbank, where the Ministry had initially planned to transfer Ukrprombank's assets and liabilities. Bagirov told us that there was "no desire" within Oshchadbank's management to take on another thorny state obligation and that Rodovid had been the only viable solution for Ukrprombank's liquidation. Later, Post learned that Platinum Bank had also bid to take over Ukrprombank's assets, but that its offer had come too late in the resolution process to be considered.

¶12. (C) Scherbyna said Rodovid analysts had calculated the bank would have to retain at least 50% of its deposit base for the projected UAH 1.5 billion recapitalization need to remain constant. However, he cautioned that if outflows were greater than expected, Rodovid would not be able to pay back all deposits "on first notice." Within Rodovid's UAH 6.4 billion loan portfolio, over 30% of the bank's credits were more than three months overdue, according to Scherbyna. While only 5% of its loans had been made in foreign currency, and all credits had been collateralized, Rodovid complained there was "no market" for premium assets, such as land plots in Kyiv, which had been collected as collateral for defaults.

¶13. (C) Rodovid has roughly $30-31 million in external debt that it is currently restructuring, roughly 10% of which had been owed to U.S.-based CoBank via a trade credit facility guaranteed by USDA's Commodity Credit Corporation (CCC). Rodovid and CCC had reached preliminary terms on a restructure agreement, pending final review by each side's legal counsel.

STATUS OF OTHER NATIONALIZED BANKS

¶14. (C) NBU crisis management director Yuriy Petrov explained to us that Ukrgasbank and Kyiv Bank had been taken out of temporary administration because both banks had established competent executive management teams and supervisory boards and were healthy enough to reinitiate commercial operations.

¶15. (C) Nonetheless, press reports have indicated that Kyiv Bank would need an additional UAH 1.5 billion in capital to compensate for the poor quality of its loan stock. It was rumored that Kyiv Bank had been stripped of its remaining assets, to the point that Bagirov had characterized the bank in August 2009 as a "shell" that should not have qualified

for state recapitalization funds. When we recently asked Bagirov about the NBU's rosy picture of Kyiv Bank, as well as the Ministry's willingness to put additional funds into the institution, he stated that while the bank remained in poor condition, the recapitalization board was unlikely to approve a further injection.

NBU RELUCTANT TO MONETIZE

¶16. (C) NBU director of economic forecasting Oleksandr Petryk told us that the investigation into NBU deputy Shapovalov (reftel) had undermined public confidence in the NBU. He said that politicians were toying with the banking regulator like a "marionette" to force it into monetizing the budget deficit and to wrest control of the NBU governorship. These games would intensify through mid-December, when NBU governor Volodymyr Stelmakh is set to retire. Petryk blamed a lack of information sharing between the NBU and the Ministry of Finance for large discrepancies in budget macroeconomic indicators, and he puzzled over how the GOU could get away from owning up to its massive core fiscal deficit.

¶17. (SBU) Commentators have noted that the NBU has refused to buy government treasury bills. Excepting NBU purchases of bonds for bank recapitalization, a commitment enshrined in Ukraine's anti-crisis legislation, the central bank may be actively refusing to conspire in the GOU's attempts to finance budgetary or extra-budgetary items, such as the UAH 9.8 billion payment for Euro 2012 infrastructure development (reftel). Furthermore, a back-of-the-envelope calculation shows that the NBU has not openly financed Naftohaz's monthly payments to Gazprom since May. PM Tymoshenko stated that the state energy company met August commitments after it received a windfall in VAT refunds, while its September payment may have come via treasury bills purchased by the state-owned Oshchadbank or from a recent $500 million loan Naftohaz allegedly took from Russian-owned Prominvestbank.

COMMENT

¶18. (C) The inability of the government and the NBU to work together, another symptom of the rivalry between the Prime Minister and the President, is negatively impacting Ukraine's capacity to work through its banking sector problems. And while the IMF supports the NBU's refusal to monetize the budget deficit and Euro 2012 payments, it seems clear that this "independence" is motivated by political factors, rather than being a sign of an autonomously functioning central bank. For her part, PM Tymoshenko appears to view the NBU as standing in the way, keeping her from realizing public promises to protect depositors and meet budget targets. With an unfinanced fiscal deficit and the presidential election fast approaching, we would not be surprised if Tymoshenko sought to gain control of the NBU after Stelmakh's retirement.
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